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A HUMAN INVESTMENT TAX CREDIT PROGRAM

SECOND REPORT

A COMPONENT OF

AN ANTI-INFLATION AND FULL EMPLOYMENT

ALTERNATIVE ECONOMIC PROGRAM

U. S. DEPARTMENT OF COMMERCE
Economic Development Administration

This technical assistance study was accomplished by professional consultants under contract with the Economic Development Administration. The statements, findings, conclusions, recommendations, and other data in this report are solely those of the contractor and do not necessarily reflect the views of the Economic Development Administration.

A DISCUSSION PAPER

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Prepared for
The Economic Development Administration
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by

Robert H. Edmonds

with

Mark Goldes
P.O. Box 880
Sebastopol, California 95472
707 525-1111

NOTE TO THE READER

This report includes as an
appendix the first report,
co-authored by L.V. Watkins.

A HUMAN INVESTMENT TAX CREDIT PROGRAM: SECOND REPORT

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I. ABSTRACT

Curing unemployment without creating new inflationary pressures is clearly possible if we view the economy from new perspectives and adopt appropriate tools and policies.

Two years ago a program of employment tax credits was suggested in a report prepared (with L.V. Watkins, Jr.) for the Economic Development Administration. This second report enlarges on but in no way contradicts the earlier study.

The primary addition is in a new analysis of causes of unemployment that suggests that "over-full" rather than merely full employment may prove possible. This analysis splits employers into three categories: large corporations, medium corporations and government, and small business. The only category having the potential to absorb large numbers of new employees appears to be the small employer. It is suggested that a goal might be possible of 3 to 6 million additional jobs in the small business sector with another 1 to 4 million becoming self-employed. A small business employment reservoir, rather than government as an employer of last resort, appears to be available.

Employment tax credits could be used as a more effective alternative to a general tax cut. This is a rifle shot approach, instead of a shotgun, aimed specifically at lessening unemployment as rapidly as possible without contributing new inflationary pressures.

A concept of the "employer force" is advanced. This seeks to supplement the existing studies of the labor force by examining the impediments to additional employment from the other side of the coin.

Long term policy would aim at the underlying structural corrections necessary for the economic roller-coaster to move toward equilibrium. Were these new directions adequately explored new management tools could become available. These include, for example, an Income Maintenance Savings Program, as an alternative to the present structure of social security, unemployment insurance, student loans and the welfare system.

A coordinated alternative economic analysis is suggested as an immediate priority that could yield large dividends. If this report can be followed quickly by the additional work that seems to be justified, a comprehensive attack on the root causes

of unemployment and inflation appears to be possible. This appears to be the first realistic alternative to an incorrect general assumption that both employment and inflation cannot be brought substantially down from currect figures simultaneously.

II. EXECUTIVE OVERVIEW

There are no domestic problems more urgent than eliminating inflation and greatly reducing unemployment. Yet, despite the widely acknowledged importance placed on these two problems, certain major, commonly held economic ideas appear to be erroneous. The needed answers lie in looking at the problems in "new" ways, to obtain insights and develop policies that are not now recognized. Economists, political leaders and the public all need to consider, as rapidly as is practical, these new perspectives.

Although a full discussion would be lengthy, the new points of view can be rapidly summarized:

1. A proper employment policy needs to be based upon several ideas that are not adequately understood:

a. A proper employment policy should be oriented towards small employers and small businesses. There is no possible way that large businesses or governments can solve the employment problems of millions of people located in hundreds of thousands of neighborhoods and communities. The "employer of last resort" should not be government or big business but the millions of Americans who comprise that heterogeneous reservoir called "small business".

b. Employers must be viewed as an extremely vital part of the employment picture. Present policies speak of creating jobs without looking properly at the situations facing those individuals who create jobs.

c. Employment (and unemployment) should be viewed as a national market relationship comprised of tens of thousands of smaller market components. These markets include over 12 million individuals, businesses and governments as employers and should include over 90 million people as employees. Policies should be designed to reach forward to an effective employment total of 100 million persons. Unemployment may properly be viewed as evidence of an imbalanced market situation. It is the logical result of public policies that interfere with or discourage and hinder some people from employing others. It may also be viewed as a situation with insufficient incentives for some people to expend the effort and money needed to succeed as employers of others.

2. The broad objective for a proper employment policy may be defined as total employment or "over-full" employment under conditions of price and monetary stability. Social conditions can be created whereby jobs are available for everyone. The method to do this lies in making it financially worthwhile for more people to become employers while at the same time strengthening those who now exist. The creation of a "labor shortage" is the best way to raise wages while providing employment for all.

3. A proper employment policy should use three complementary methods of protecting and developing jobs and minimizing unemployment. The first is to eliminate a wide variety of deterrents to job creation. The second is to encourage and foster job development through devices such as tax credits. The third is to lessen unemployment by reducing financial incentives that encourage idleness and unemployment.

4. A major policy initiative of a somewhat different type would be to free very small employers, with up to four employees, from the requirements of reporting and collecting social security, sales, and income taxes; and also from local taxes designed to raise revenue rather than assure health and sanitation compliance. They should also be freed from many other types of government and union interferences in employer-employee relationships. No employer of one to four people can exercise unfair domination over his employees if alternative job opportunities are readily available, as they would be under an over-full employment policy. It is not a proper concept of state functions or public policy to try to interfere with the very smallest details of economic life. One does not foster widespread employment by making it prohibitively difficult for very small employers to exist.

5. The major way to encourage job developments is to use job tax credits. A number of provisions can be summarized briefly:

a. A $500 per person tax credit for existing employees. This credit would be limited to $2,000 for an individual and $10,000 for a corporation.

b. A $1,000 per person tax credit to employers for hiring additional people. This credit would be $1,500 per person where individuals hired are under 20 years of age. Such credits would be limited in amount for each employer to perhaps $10,000 per year for an individual and $50,000 for a corporation.

c. A $500 maximum tax credit per person to provide a Workshare Bonus to employees who work short weeks and thereby spread available employment.

d. A $2,000 maximum tax credit for self-employed individuals to help facilitate self-employment.

e. A $500 per person training credit to employers who participate in training programs to improve job related skills of employees. Again the amount would be limited with primary encouragement to small business.

f. A $500 credit to corporations to match or stimulate expanded equity ownership by employees.

6. A major rationale for a broadly based, limited size job tax credit lies in the fact that a high proportion of small employers are short of capital needed to support continuing and growing employment relationships. It is therefore counterproductive to tax incomes of those who provide jobs and thereby limit their chances for success or growth. Job tax credits allow employers to retain earned income to create more jobs.

7. A second reason for job tax credits arises from the minimum wage laws. A substantial portion of teenage unemployment can be attributed directly to such laws. As long as they are retained on the books, the costs which they impose on individuals should be paid in some way from the public purse. This would be the only way to offset or lessen the unemployment which such laws produce.

8. Brief mention should be made of the fact that unemployment is sometimes overstated and its costs inflated by the availability of some portions of welfare grants, unemployment insurance and industry-union supplementary unemployment benefits. Some portions of unemployment are artificial and are, in fact, paid vacations. The proper answer to this problem lies in the creation of an Income Maintenance Savings Fund in place of the present system of social security, unemployment insurance and educational loans. Under the proposed system, loans would be widely available for income maintenance purposes. Individual accounts would be established and drawn down when necessary. This proposed system is described in greater detail below.

9. Monetary policy and employment policy should be clearly separated. Inflation and unemployment are two different and distinct problems. It is incorrect to use monetary policy (i.e., inflation) to seek to raise the levels of employment and production. There is only one simple objective for a proper monetary policy. That is to seek and attain price stability. This can be done through proper limitation of the quantity of money created by the monetary and banking system. Our present monetary policies diverge considerably from this simple and proper goal.

III. INTRODUCTION

This report is the outgrowth of an earlier study co-authored with L.V. Watkins, Jr., entitled "Human Investment Tax Credit: A Component of An Anti-Inflation And Full Employment Tax Reform Program". A copy of that report is attached as Appendix A. Although made two years ago, we find only minor matters of substance that we would change. This report adds to rather than duplicates that report. We request full perusal of Appendix A as an integral part of this report.

During the past two years, our thoughts on the problems of unemployment and its relationship to inflation and other problems have undergone further evolution. We hope that the same process of search for change and new ideas is being shared by many other individuals.

At the time of our first report, we felt that it broke new ground in the area of thinking about one of our major economic problems -- unemployment. We feel that the present report makes a number of suggestions for new ways of understanding and solving both this and related problems. These suggestions deserve extended consideration and we urge that they be examined with an open mind and with a paramount concern for finding new answers.

One of the problems of a report such as this is that its scope is limited by two main factors. First, a specific topic is contracted for study. Secondly, that topic usually comes under a specific governmental jurisdiction. Other topics may be vitally related to the subject, but it is not administratively proper to comment too heavily on matters that fall with the purview of other agencies. The problem is similar to the problem of interdisciplinary coordination in academic circles.

In our opinion, the problems of unemployment cannot and will not be properly solved without reference to related areas under other governmental jurisdictions. We therefore hope that proper multiparty consideration and evaluation will soon become feasible.

IV. SUMMARY OF THE PRIOR REPORT

Our previous report, which is presented in full in Appendix A, suggested enactment of a new type of tax credit having the following provisions:

1. A $1,000 per person credit to employers for hiring additional people. This credit would be $1,500 per person where individuals hired are under 20 years of age.

2. A $500 maximum tax credit per person to provide a Workshare bonus to employees who accept short work weeks to spread available employment.

3. A $500 credit to corporations to match or stimulate expanded equity ownership by employees.

4. A $2,500 maximum tax credit for self-employed individuals to balance self-employed and corporate tax deferred retirement incentives.

5. A $500 per person credit to employers for utilizing approved training programs to improve job related skills of new and existing employees.

This multi-part credit was proposed to foster investment by employers in their employees and economic stability for self-employed persons, in order to increase employment opportunities, expand savings and equity ownership and improve training opportunities.

The earlier report included an executive summary which can be rapidly reviewed.

V. ADDITIONAL PROPOSALS

We make four additional proposals for inclusion in an employment tax credit law: first, to provide for a base employment tax credit; second, to suggest specific limits for total credits that may be claimed by a taxpayer; third, to suggest that a life of 5 years be placed on any proposal adopted, and fourth, to modify the annual hours to which the tax credit applies.

Base Employment Tax Credit

We suggest that a $500 per person tax credit be allowed for each employer for existing employees, subject to the limits below.

In preparing our prior report, we had considered this proposal but dropped it on grounds that it might not provide extra jobs adequate to justify the expense incurred through the tax credits. We are including it in this revision because we believe it merits further consideration and analysis.

LIMITS

In our prior proposal, we suggested that Congress might want to set limits. It is of course still true that any limits to be set will be determined by the Congress. However, the following limits will provide a starting point for discussion and thinking.

Provisions	Maximum Tax Credit Per Employee	Per Individual Employer	Per Corporate Employer
Base tax credit	$ 500	$2,000	$10,000
Additional Employees: Age 20 and above	1,000	4,000	20,000
Below age 20	1,500	6,000	30,000
Self-employed individuals	2,500	2,500	NONE
Training credits	500	1,000	20,000
Employee Ownership	500	NONE	50,000
Maximum total credit except Workshare Bonus		$10,000	$100,000
Workshare Bonus		2,000	50,000

The above proposal sets a maximum tax credit for each taxpayer that is less than the sum of the totals for each type of tax credit. It is assumed that different employers may use different provisions in varying ways and proportions. Partnerships would be allowed to designate portions of expenses eligible for tax credits. However, actual tax credits, subject to appropriate limits would be available only on the tax returns of individuals, not on partnership tax returns. Partnerships, of course, are not income tax paying entities. The Workshare Bonus limit is separate because this amount is passed through to the employee and is not a net benefit to the employer.

Limited Life

We suggest that this law be written with an initial life of 5 years. This is a long enough period of time to allow individuals and corporations to make business decisions on the basis of these provisions. It will give time enough to see if the incentives are effective in creating additional jobs. During the initial 5 years, other changes may also be effected so that reanalysis and reconsideration would allow renewal if appropriate.

Hours of Work

We suggest that the annual hours of work for which the credit applies be changed from our prior suggestions of 1,000 hours per year to 1,500 hours per year for teenagers and 2,000 hours per year for those above age 20. In this fashion, the $500 allowance for existing employees equals 25 cents per hour for eligible workers. The $1,000 allowance

equals 50 cents per hour for additional over-20 workers. And the $1,500 allowance equals $1.00 per hour for teenagers. Shorter periods of employment would earn pro-rata credits.

The reason for this change is the misgiving that the 1,000 hour base might induce some employers to change employees unnecessarily in order to qualify for extra credits.

We also suggest that additional employment be eligible only above the previous total hours of work, excluding only paid overtime above 40 hours per week. This may encourage hiring additional employees in place of prior overtime. It will not, however, encourage cutting hours of work of adults just in order to hire more persons at the subsidy rate, except as covered by the Workshare Bonus provision.

VI. SUPPORTING DISCUSSION: A REALISTIC VIEW OF JOB CREATION

In our opinion, past and present policies aimed at job expansion have proved inadequate because they have not been based upon sufficiently accurate ideas about the real world job markets.

1). Some Relevant Concepts

For our discussion, we wish to use a number of concepts, some of which are new and seem desirable for clarifying policy thinking. A list of the concepts is as follows:

1. Total Employment
2. Dual economy and dual labor markets
3. Primary, secondary and tertiary employment
4. The Market for Employers
5. Reservoir of employment

Total Employment

Total employment is defined as a social objective in which the number of job openings equals or exceeds the number of persons seeking work. Our national employment statistics emphasize people seeking work, not job positions for which people are sought. Yet, the metropolitan daily papers have numerous job openings. The balance, however, is that unemployment substantially exceeds the number of job openings. There is a need for greater job creation.

Total employment defines a situation in which all unemployment is frictional and transitional.

Dual Economy

Dual economy and dual labor markets are terms developed by economists to refer to the fact that certain portions of our economy are dominated by large corporations. These corporations have very substantial effects upon the setting of prices. Their so-called administered prices are set at a higher level than would apply in truly competitive markets. Although such manufacturers "compete" with each other for available business, the financial strength of some is so great that the limited competition by others cannot seriously affect their pricing and profit target policies.

Because the large corporations generate excess price and profit levels through price leadership and restricted competition, they are the major targets for the countervailing power of labor unions. Large unions have developed in order to draw part or most of the profits of large business into wage levels above those of the more competitive industries. Dual labor market analysis suggests that a substantial wage discrepancy exists between price administered industries and truly competitive industries.

Primary, Secondary, and Tertiary Employment

Based partly on the dual market concepts, we suggest it may be desirable to think of employment in three strata terminology: as primary, secondary, and tertiary employment markets. We would define primary markets as those involving very substantial market strength on the part of employers and above average pay levels on the part of employees. The goods and services produced in this sector are relatively well defined. Conditions of competition are restricted. Wage and business earnings levels are generally above average. Labor is more highly unionized than elsewhere. Employment duration tends to be long term and to involve savings and retirement components.

Secondary employment involves primarily a greater degree of competitiveness among employers. Wage levels are generally below those of primary employment. Unionization is also less. Government employment should primarily fall in the classification of secondary employment despite the monopolistic nature of many governmental functions. The fact that basic income is received from taxes rather than from voluntary payments sets a limit of resistance upon the ability of the public entities to raise money and pay ever higher wages. Professional employment, even though usually small scale, should probably be treated as secondary because of the substantial skill levels involved and reasonable permanence of employment.

The fact that primary employment generally offers higher wage incomes than secondary employment is a source of increasing pressure and strain within the secondary employment areas, Public employee unionization and strikes are a humanly understandable effort to obtain "fair" incomes that are comparable to the standards in primary employment.

Both primary and secondary employment sectors embrace employers who have both well defined market functions and the organizational strength to offer continuing employment relationships. However, since their markets and functions are relatively well defined, they are seldom subject to significant or rapid factors of expansion. Even when a large firm opens a new plant and adds employees, this may well be at the expense of employment in other companies.

Tertiary employment is a term we suggest for employment which is neither primary or secondary. It would include all small business up to 100 employees and perhaps even larger, which covers approximately 85 percent of all employers. Also included are occasional jobs involving little skill, and short term jobs that might involve substantial skills, transitional jobs, and seasonal employment of diverse sorts. Self-employed individuals whose incomes are dependent jointly upon their own skills and initiative and upon the needs of other people for their services and government employees who would be dropped if adequate private job openings could be created would also be included.

The size and strength of individual employers in tertiary employment is much smaller and the markets for products or services are much more competitive. The income levels of customers for marginal services in the tertiary field would be the lowest income levels in the economy. Wage levels will, in general, be below those of either primary or secondary employment. The level of skills may frequently also be lower.

The Market for Employers

The market for employers is a highly neglected or nonexistent concept. It is concerned with the problems of how many people (or corporations) are or could become employers. It is obviously true that for each employee there must be an employer. We could even define unemployment as employees without employers. The only possibile exception is those who are self-employed. The term "labor force", used to apply to all persons working or wanting to work, is a long established concept. There is no concept of the "employer force" for those who want or may want to hire other people. Data about employers is extremely hard to obtain and may not be too reliable.

One of the major contributions that this study may make is to point out that our dominant ideas about employment may be faulty because we have failed to understand the two sided nature of the employment market. We have studied only those who want to be hired. We have not studied those who want to hire. A realistic and accurate view of employer problems and incentives is essential if we are to solve problems we have hitherto failed to solve.

Reservoir of Employment

Reservoir of employment is a term that should be used in preference to the concept of "last resort" employment.

It is sometimes asserted that, if the unemployed cannot be hired by private employers, government should become the "employer of last resort". This concept usually concedes that governmental entities cannot employ all unemployed people at useful work so it tends to merge with the concepts of a guaranteed wage or an assured (unearned) living income. This approach never examines realistically what changes would be required in a two-sided employment market for all persons to be usefully employed on a non-governmental basis.

Our dominant thinking about employment is conditioned by the circumstances of the primary labor market or the price administered sector of the dual economy. The concepts above seem to suggest that all persons should be able to be employed on a comparable basis. However, this interpretation has consistently proved to be unreal.

Examination of the primary employment sectors indicates structured markets, protected prices, high wages, and relatively large capital investments. Because of market limitations, there is little opportunity for substantial employment expansion in the sale of such well established goods and services. So called "normal" growth needs may be met by technological improvements with little or no gain in employment. Despite the fact that government contracts and employment regulations have sought to change the social balance of primary employment and create additional jobs, the high costs of and market limitations of this sector make it absolutely impossible that large scale business can become a collective "employer of last resort". This impossibility should be clearly realized since the usual argument for capital investment tax credits seeks justification on the grounds of creating jobs. In addition, capital is invested in high wage industries primarily in order to save on high wage costs. It certainly cannot create significant additional employment in the secondary or tertiary sectors. The substantial capital requirements of large industry may, however, squeeze out of the capital market most of the credit needs of the smaller businesses in the secondary or tertiary sectors.

In a similar fashion, the secondary employment sector, including most government, cannot provide the additional job opportunities to attain "total" employment. These industries are not the leading sectors of the economy but they do have specific markets, even if they are reasonably competitive, and their market limitations are very real. Government is still a minor sector of the economy but it my already have expanded beyond its proper functions. Certainly, there is substantial resentment towards both taxes and deficit financing.

Only the tertiary sector, in proper combination with the primary and secondary sectors, can provide that reservoir of employment which public policy should seek to develop. In addition to jobs which now exist in the tertiary sector, we should consider that there are millions of people with desires and needs who might be employers

under the proper circumstances. These people are potential entrants into the "employer force". We are then looking at the stock of total employment, in the range of 86 million civilian jobs (of which 71 million are non-governmental) and saying there are unmet human needs for which we would like to see employers create another 7 to 10 million jobs. We are looking at the margins of total employment throughout the whole economy and asking: Who can hire additional people? What are the necessary conditions to convert potential jobs into actual openings?

We can view the employer population as totalling about 12 million employing entities. At least 85 percent of those employers are very small, with less than 10 employees. They constitute most of the employers in the tertiary sector. Their employees may constitute about 25 percent of private employees. An increase of say 6 million jobs in this sector would be almost a 30 percent increase in tertiary sector employment. The magnitude of this estimate should emphasize that a major shift in incentives and hiring capabilities is absolutely required if an adequate number of job openings are to be created. Perhaps, there should be another 1 to 4 million self-employed individuals and another 1 million small employers not now an actual part of the "employer force".

One major point to realize about this employment reservoir is that it is the source through which we should seek to serve needs that are not now being met. There is a tremendous diversity of jobs to be done, of people to hire others, of people to be hired, and of places where job needs exist. This diversity makes it impossible to think that large businesses or any level of government can realistically develop this reservoir properly. It is more accurate to think that the people as a whole are the reservoir of employers as well as employees. The problem is to remove obstacles to the hiring of some people by others and give incentives, if necessary, for new jobs to be created. The Employment Tax Credit seeks to fill the latter need.

2). Capital Requirements and Job Creation

Standard estimates of capital formation and capital requirements for job expansion to "full" employment lead to irreconcilable and unsatisfactory alternatives. The first is that we are seriously short of the capital required and must take steps to vastly increase our savings and methods of capital formation. The second alternative is that if we do not obtain adquate capital, we will remain seriously below a satisfactory level of employment.

The "capital shortage" argument rest primarily upon capital utilization in the primary employment sector of the economy. That sector, although comprised of perhaps only 5,000 firms, supplies from one third to one-half of our total employment. Because of market limitations, such firms cannot supply

a proper base for total future job expansion. When they expand, they are as likely to reduce total employment as increase it. Such standard capital formation studies are therefore methodologically wrong. The primary sector uses more capital because its firms have attained market dominance and its unions have won high wages. The whole sector draws its high income existence partly at the expense of the other sectors of the population. It would take very careful analysis to know what validity, if any, such studies can have.

A more accurate method of analysis would be to cease all inflationary money expansion, then take the levels of non-inflationary capital aggregation that have applied in the past and divide by the approximate number of jobs to be created. A schedule of job capital requirements could be created based upon skill levels and capital requirements of the secondary and tertiary employment sectors instead of the primary sector. Under non-inflationary conditions, with finite or limited capital sums, it would be possible to devise methods for using small amounts of capital to create jobs in circumstances where large capital aggregations cannot create the desired jobs and may very well worsen the overall employment situation.

In the past, large scale capital accumulations have been viewed as useful and desirable. Under future conditions, it may well be that smaller scale, widely dispersed capital availability will be a key to economic health. Certainly, taxing money away from small employers who are short of capital will not help solve the employment problem. Employment Tax Credits are one way of leaving job capital funds in employers' hands.

The question of whether limited capital sums should be used so as to facilitate the creation of a maximum number of jobs is one of national priorities. Job creation through realistic methods should rate very highly.

3). Economic Stimulus: What tools?

What means exist for action by government to help reduce unemployment and "stimulate" the economy? Are such means helpful and desirable or harmful and undesirable? What means will give the most beneficial effects for the smallest amounts of money?

A primary means in past thinking has been monetary policy. Our previous comments have indicated that we think monetary expansion is a harmful means of policy action. We strongly argue for monetary limitations guided towards price stability.

A secondary means in past thinking has been deficit financing of portions of government spending so that government expenditures exceed government revenues. The major policy device for increasing fiscal deficits has been a general reduction of income taxes for both individuals and corporations. Tax reductions for individuals increase personal disposable income and thereby increase aggregate demand. This policy is widely considered to have been effective in the early 1960's. However, the effect of an increase in aggregate demand upon employment is indirect and depends upon other factors as well. We therefore believe the conclusion should be logically clear that tax credits

that directly stimulate employment should have a multiplier effect in comparison with a general tax reduction. Only in the case of teenage employment does the ratio of our suggested tax credit begin to reach 50 per cent of the employees wages. The more typical ratio would be 25 per cent. This means that the private employers are in general willing to spend from one to three dollars of their own money for each dollar of tax credit money received. It is perhaps reasonable to assume an average multiplier of three so that the total effect upon employment will be three times the amount allocated as stimulus.

It is our assumption that the proper objective of "stimulus" is not inflation or higher profits or higher wages for those employed but is specifically targeted at reducing unemployment and increasing the level of useful employment. If this objective is correctly stated, then the primary criterion for policy is: Does it increase useful employment?

We cannot argue that the employment tax credit would have an immediate and visible effect upon retail trade as would a general tax reduction or rebate. This is not and cannot be the case. What we do argue is that the effect upon employment, which will be gradual and difficult at best, will be much faster and more effective through the Employment Tax Credit. And that is the real purpose for using stimulative tax deficits.

Because of the reduction in unemployment insurance expenditures and the increase in various forms of tax revenues, we can anticipate that expenditures through the Employment Tax Credit are far more likely to be "self-financing" than any general income tax credit.

4). <u>A Comparison of the Employment Tax Credit with the Capital Investment Tax Credit</u>

Our original study suggested that capital investment tax credits might be a less desirable means to stimulate job formation than employment tax credits. It should presumably be clear from our preceding comments that we now definitely consider capital investment tax credits to be generally harmful and counterproductive. We make an exception for pollution control equipment where the capital expenditures are imposed by government-set standards for public purposes.

It is our opinion that a substantial portion of the case usually made for capital investment tax credits rests upon inflation and its distorting effects upon virtually all business decisions. We consider that proper fiscal and tax policy decisions require the elimination of inflation so that economic problems and solutions can be seen in a truer light.

A thorough study of the effect of other taxes and fiscal devices on job creation under non-inflationary conditions would be desired. Such a study lies outside our present scope.

5). <u>Job Expansion Goals</u>

We consider it reasonable to set targets of creating an additional 1 to 4 million self-employed persons, and an additional 1 million employers (primarily individuals) and creating 3 to 6 million additional job openings for the private economy.

Past performance has averaged about 600,000 to 700,000 additional private employment positions per year so even a doubling of past performance would require several years for accomplishment.

We do not suggest these targets as having any great numerical significance or precision. We think, however, that examination of the relevant magnitudes can help in selecting realistic and appropriate public goals. We hope this will lead to more meaningful goals and a consensus on reaching them. Because of the substantial political opposition to both taxation and public spending levels, we shy away from any consideration of increases in public employment. In fact, it seems more likely that if an additional 5 million jobs can be created in the private sector, it then will become realistic to analyze possibilities for reducing the levels of tax supported employment. For comparison, recent unemployment has ranged from 7 to 8 million.

We suggest that if substantially increased goals are not adopted for private job creation, methods to do the job may not be developed. We, of course, suggest that Employment Tax Credits are one of the major methods for this, and that such a program should be adopted at the earliest possible date.

VII. RELATED ASPECTS OF THE TOTAL EMPLOYMENT PROBLEM

1. Monetary Policy and Price Stability

This study rests upon the assumption that price stability is desirable and can be attained. The essential factor is that present monetary policy needs to be changed from the objective of controlled inflation to one of price stability. The full scope of this issue goes well beyond the framework of this study. However, it seems clear that a policy of price stability needs the device of employment tax credits in order to be economically and politically feasible.

2. Employment Deterrents and Disincentives

The subject of employment deterrents and disincentives has received some attention but not the amount it deserves. It seems wholly logical that barriers to the employment relationship should be removed if at all possible. It may be theoretically possible (although doubtful) that employment tax credits would not be needed if total employment could be reached through the removal of all job barriers. Among examples of job barriers are some cases of unemployment insurance, some situations of welfare grants, the social security barrier to additional earned incomes above very limited amounts, minimum wages and the numerous reporting and tax collecting obligations that small businesses face.

One idea that merits study is the possible effect of relinquishing a variety of controls and legal requirements on very small business and hiring relationships. It would be possible, for example, that the hiring of up to 4 persons could be exempted from social security taxes, income tax withholding, state sales tax collection, and minimum wage laws. It can be argued that it is not a proper function of government (certainly not the Federal Government) to regulate economic agreements between individuals.

The present burden of governmental regulation is such that some actual employment relationships are thought to evade or ignore provisions of law. Such employment is presently illegal, but we ought to examine carefully the possibility that such laws may themselves be wrong and socially counterproductive. Artificial barriers to employment deserve removal wherever possible.

3. Growth and Appropriate Technology

In our initial report, we criticized the assumption of continuous quantitative growth implicitly sought by conventional economic policy and doctrine. In the interim, a book by E.F. Schumacher, entitled "Small is Beautiful", has become well known. This book advanced the concept that less developed countries should not blindly copy the latest technologies used in the advanced countries. We have also, in recent years, had occasion to question whether developments such as the supersonic transport, nuclear power, pesticides, aerosols, and many other technological steps are, in fact, desirable advances. We have reached the point where

technology is capable of destroying the world and the environment. The further advance of civilization rests on the wisdom not to do many things that could be done. In this regard, the phrase, "appropriate technology", implies the examination of all technology to determine whether specific possibilities are desirable or not. The search for appropriate technology and practices in all fields of the economy can be a very penetrating search. Judgment and wisdom become essential elements in appraising growth.

4. Savings, Wealth Concentration and Job Creation Opportunity

In our prior report, we suggested that one provision of an Employment Tax Credit should give incentives for corporate employers to seek employee participation in corporate ownership through acquisition of shares. One of the main reasons behind this suggestion was to seek to strengthen what should be common bonds of interest between corporations and their employees. Industrial strife would be reduced and efficiency increased.

Such a provision would also clearly induce a more widespread ownership of savings. In reference to our suggestion that tertiary employment is the proper job reservoir for creating total employment, we cannot tell who within the present employed population may become the employers of tomorrow. The availability of widely owned corporate equities should make more feasible the future transfers of employees to self-employment or to small scale employer status.

Present tendencies towards preserving a substantial concentration of wealth in both the personal and corporate sectors act to deny the necessary widespread access to small capital sums. Wealth concentration defeats the objective of widespread job opportunities.

Data on wealth totals and distribution indicate it is clearly feasible for an individual and wife to accumulate an estate of $150,000 or more before retirement. In addition, retirement studies indicate that retirement desires are strongly correlated with a comfortable financial status at time of retirement. Widespread dispersion of wealth therefore makes it possible for persons to voluntarily withdraw from the work force at an earlier age than would be required by law or physical condition. This, of course, leaves job openings for others to fill. It is one of the reasons why a conscious wealth deconcentration program is desirable to assist in solving the basic problem of widespread unemployment.

5. Job Expansion and Credit Access

A monetary policy that seeks price stability may require little or no growth in the money supply. Such a policy can be compared with present monetary growth targets of 5 to 7.5 percent per year.

Severe limitations on money growth imply that lessened amounts of bank credit will be available. An immedi-

ate question arises as to how limited credit amounts shall be allocated. Should credit go to the largest firms, with small businesses losing access to credit? If so, the job problem becomes more insoluble than ever. The conclusion must be that large scale access to credit must be restricted in favor of small scale access. This is the only path consistent with both targets of price stability and total employment.

A thorough study of alternate methods of dispersed credit access (or alternative methods of credit allocation) and their effects on job creation would be most desirable.

6. Banking as the Catalyst for Total Employment

In order to create widespread access to productive credit is a necessity. This task can be done only by bankers, not by government. The question is: How can bankers be induced to undertake the task of widespread small business stimulation leading to fuller employment? Can the resources and abilities of the banking community help solve the multiple problems of structural unemployment?

Two devices in government policy can be used to stimulate a major effort by banks. The first is tax exemption or tax reduction; the second is subsidization. We will describe a system which can be created to use tax exemption as the major incentive.

We propose creating a special category of bank loans which we will call National Purpose Loans (NP loans). Such loans shall be for two main purposes: job expansion and employee ownership expansion. It shall be optional for banks to utilize these provisions but the aim is to make it in their interest to do so. Most bank loans will presumably continue to be of the conventional type, but we add a significant option.

To make NP loans attractive to banks, we propose that all interest earned by the bank on such loans shall be exempt from income tax. As a further incentive, we propose that a bonus tax credit equal to 10 percent of the interest so earned shall be offset against other tax liabilities. In this fashion, there will be some extra compensation for extra risks generally associated with small business loans and with the fact that small loans, regardless of risk factors, cost more to administer than large loans.

No loan for consumption purposes shall qualify as a National Purpose Loan under this proposal; all loans must be for productive purposes. No loan involving the purchase or financing of real estate may qualify unless real estate aspects are minor and not separable from the total transaction. However, it may be that home improvement loans should be included so this possibility should be further examined.

Each NP loan should not exceed $10,000 per borrower with the exception that if the borrower regularly employs more than two employees, or shows that he will hire more than two, this limit may be increased by $5,000 per employee over two up to a maximum loan of $25,000. The period of time of such loans shall not be more than three years, and they must be at least one-half amortized by the end of three years.

In making National Purpose Loans banks may establish insurance and loan loss reserves and require life and other types of insurance so as to cover certain obvious risks within this program. However, all such costs and reserves should not exceed more than, say, seven percent of the face value of any loan. Surpluses from loss reserves shall be rebated to borrowers at the termination of all loans of the same class or pool. Any insurance or loan reserves shall bear a reasonable relationship to the amount of security supporting the loan. For insurance and potential rebate purposes, NP loans shall be aggregated in loan pools or funds relating to a limited area and covering a period of loan creation not exceeding one year.

All NP loans shall be made only to residents living and working within a radius of 100 miles of the bank (or branch) making the loan.

National Purpose Loans may not be made to corporations, only to individuals. If corporations and banks together desire to use these provisions, such loans may be used to finance the purchase of corporate common stock by its own employees. The corporation may co-sign the loans or sign a master loan agreement assuming recourse responsibility. Whether the corporation contributes towards the repayment of either interest or principal is a matter between the corporation and its employees, not the bank or the NP loan program.

The corporate purpose for NP loans may be job expansion or debt retirement to improve financial soundness. Such a loan may not be used to purchase another firm unless the combined employment of both firms is less than 500 employees.

In order to assure wide availability of loan funds for NP loans, the total size of a master loan guarantee by a corporation should be strictly limited. Otherwise the large corporations might gobble up available funds and defeat the whole rationale of the program. For most cases we would suggest a limit of one million dollars per corporation or a smaller figure not exceeding $5,000 per employee participating in the arrangement.

For one special case we would raise the above limits to 10 million dollars total and $10,000 per employee. That would be for the purchase by employees of 25 percent or more of their employing firm's common stock. In such a case the amortization period should be extended to five years on the basis of fully amortized payments.

Corporate stock purchased by means of an NP loan would naturally be pledged as security for the loan. Dividends would presumably also be pledged for loan repayment. Cash downpayments against such stock purchase loans may be required but they should not exceed 25 percent. Margin requirements in the stock market should not be considered relevant.

Because of the pooling or funding arrangement suggested above, we consider it possible that banks might use one or more portfolios of such loans as security for participating loans by insurance companies or other financial institutions.

Since the local banks would be servicing agents on such loans, the movement trend of banking funds from small banks to large might be significantly reversed.

It should be re-emphasized that this program does not interfere with banks making other loans as they see fit. NP loans may be supplemented by conventional loans. Clearly the existence of a program such as this should help reverse the trend of excessive concentration of people, employment, income, power, and savings into limited geographic areas including large cities.

Nothing about this proposal suggests that banks should make loans which appear to them unsound or inadequately protected by assets, insurance, or loan loss reserves. Within a framework of monetary price stability and credit limitation, it offers a way to create maximum employment at minimum social costs.

As a related matter, we might suggest it would be desirable to greatly simplify the SEC provisions for issuance of new stock for purposes of employee purchases. The limit of $1,000,000 used above would be an appropriate cutoff point.

7. <u>An Income Maintenance Savings System</u>

Our present systems of income maintenance include social security, unemployment insurance, educational grants and numerous forms of welfare. Economic studies indicate that incentives to save are adversely affected by the illusory belief in state provision of general welfare. A major suggestion for reform is that such grants should be converted to loans. In that way, the disincentive work-deterrent character of such grants could be substantially reduced without decreasing true income maintenance needs.

An alternative system of income maintenance savings accounts, with its potential effects in reducing unemployment and filling job needs should be carefully studied. As presently proposed, income maintenance savings accounts would include such features as the following:

a. Present social security balances would be converted to interest bearing savings accounts.
b. Both employer and employee social security contributions should be unified and credited to the account.
c. A limited sum of each year's income taxes might also be credited to individual accounts.
d. Contributions to such accounts would no longer be obligatory if the level reached $50,000 per person.
e. Contributions to such accounts would be divided equally between husband and wife.
f. Such accounts, properly identified, might be kept as blocked accounts in savings and loan associations.
g. At least half of unemployment insurance payments to individuals would be drawn from the individual's account.

h. Educational grants would be made largely against individual loan accounts with future repayments being made automatically from income maintenance taxes at a level of 10 to 15 percent of earnings.
i. At time of retirement, the amount of a retirement grant would constitute an annuity based on the age of the recipient and the amount of the savings account.

Limitations on old age earnings, of course, should be removed.

In our opinion, these subordinate proposals merit elaboration and analysis in studies separate from the present paper.

8. <u>Welfare and Tertiary Employment</u>

An important part of tertiary sector employment deals with the creation of jobs for persons on various forms of welfare, for those drawing unemployment checks and for those who have neither job related or welfare income.

To a substantial extent, the jobs to be created will be to assist low income people in meeting needs that are presently unmet. In other words, many of the jobs have to be created, in a very literal sense.

To facilitate an integration of welfare problems into a perspective seeking total employment, several changes need to be made in the principles guiding the purposes and administration of welfare.

1. Welfare administration should be unified on a decentralized basis. The various welfare programs all depend on income qualifications but none of them screen qualifications adequately. Food stamps and housing and interest subsidies should be combined with standard welfare administration.

2. Welfare payments should be changed as much as possible from a grant basis to payment for services rendered.

3. Welfare administration should be changed from centralized bureaucratic individualistic administration to mutual assistance, self-help, group administration. Decentralized localized group meetings should provide the basis for developing mutual assistance services.

4. Indirect job administration paid for by welfare allotments should be developed. This method should complement Employment Tax Credit provisions. It should develop welfare payments as seed money to help small business contractors provide low priced services for low income residents. Examples of services that can be developed are child care centers, food service centers, general services for the elderly and disabled and housing maintenance for income home owners.

5. Mutual assistance welfare channels should be available to work with low income persons in general who are not on welfare but who can benefit from working with the reformed localized structure.

Ideas such as these deserve careful development and experimental application. They are vital for developing realistic job solutions at the low income end of the employment reservoir. Such methods can open the path to initial job experience and provide for gradual upward job mobility in accordance with ability and experience.

VIII. OTHER HUMAN INVESTMENT TAX CREDIT PROPOSALS

A number of studies of the Employment Tax Credit have been made since our prior study and a few prior to it. The most recent study to come to our attention was by Gary C. Fethke and Samuel H. Williamson, both Professors of Economics at the University of Iowa. That study was prepared for the Subcommittee on Economic Growth of the Joint Economic Committee and is available from it or from the Government Printing Office. That study includes a bibliography which refers to prior studies largely in academic circles. Our prior study is not mentioned and was apparently unavailable to the professors.

A substantial difference in methodology exists between these two studies as well as in the recommended form for an Employment Tax Credit. The form preferred by Fethke and Williamson is a Variable Base Fmployment Credit, calculated on the basis of pay roll taxes so that it can be effective with firms not earning a taxable profit. This method of calculation also enables government units and non-profit organizations to be included in the measure.

The V.B.E.C. is viewed as an anti-cyclical fiscal policy tool designed to encourage additional employment on economic upswings and discourage firings on economic downswings. Variations are expected to be determined for the base above which "additional employment" is to be measured as well as the tax rebate rate applicable above the exempt base.

One of the chief methods of the study is to establish a multi-variable model of the economy. A range of alternate fiscal conditions as well as variations in the control variable are stimulated and examined by means of this model.

Certain conclusions indicated by the authors appear to reinforce our own conclusions that an employment tax credit is an extremely desirable fiscal policy tool that should be developed. One of their conclusions is that under proper admininstration the tax credit would not only be effective in increasing employment but the program would be "self-financing". That is, revenue lost through tax

credits would be offset by reduced unemployment and welfare expenditures, and by increased taxes arising from the increased employment.

A second significant conclusion of the study is that it argues even more strongly than ours that the capital investment tax credit is not really as effective as the employment tax credit.

Despite similar aims and some similar conclusions the difference between our studies are great enough so that they complement rather than duplicate each other. Differences in form are apparent from our study without repetition here. However, the difference in broad scope and objectives is worth noting. Our study draws its conclusions from observations about the actual economy rather than using a modeling technique. We view the employment tax credit as the means that can make feasible a realistic policy of price stabilization. We are therefore seeking structural changes in the economy, primarily on the small-employer side of the labor market. This is an approach which extends beyond cyclical considerations. In addition, our framework opens the possibility of later application to the problems of government deficits.

We trust that Congress will take both of these approaches under study as they decide what provisions shall be embodied in new laws.

HUMAN INVESTMENT TAX CREDIT:

A COMPONENT OF

AN ANTI-INFLATION AND FULL EMPLOYMENT

TAX REFORM PROGRAM

Prepared for
The Economic Development Administration
U.S. Department of Commerce

by

L.V. Watkins, Jr.

and

Robert H. Edmonds

with

Mark Goldes

National Area Development Institute
P.O. Box 11890
Lexington, Ky. 40511

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ABSTRACT

Solving the problems of unemployment and recession without creating further inflation requires a fundamentally new and creative approach. A Human Investment Tax Credit is proposed as an effective anti-inflation, anti-recession measure which attacks unemployment directly rather than continuing to use an indirect and possibly harmful route.

There is now increasing awareness that the roots of our current difficulties are centered within structural inequities. Not enough attention has been given to long and short term tax adjustments which could correlate aggragate demand, economic expansion, full employment and price stability.

The Human Investment Tax Credit is designed to initially complement and eventually replace the capital investment tax credit. It accomplishes a number of purposes which the capital investment tax credit can not:

1. The capital investment tax credit does not directly assure increased employment. The Human Investment Tax Credit virtually assures increased employment.

2. The capital investment tax credit artificially stimulates demand for capital which is inflationary and wasteful. The Human Investment Tax Credit promotes a natural balance between capital and labor.

3. The Human Investment Tax Credit stimulates competition by encouraging millions of small employers and professional people to expand. The capital investment tax credit promotes economic market concentration and monopoly.

Preliminary analysis indicates that the Human Investment Tax Credit offers the greatest benefit for the costs involved. These benefits include:

1. An increase in private sector employment followed by a dramatic decrease in Federal expenditures for unemployment insurance and "make work projects."

2. More effective utilization of savings and investment.

3. Maximized utilization of limited non-renewable resources through utilization of private incentive and flexible utilizaiton of innovative technology.

4. Accelerated production of needed goods and services especially in the areas of housing and energy.

5. Correlation of training with direct employment and expansion.

6. A shift in emphasis from the present policy of quantitative growth and a preferential treatment of capital to qualitative people centered growth based on maximizing human capital and expanding free enterprise.

It is now clear that present policies based on fiscal and monetary measures are not adequate to meet the demands of our present economic dilemma. An emergency tax cut has already been enacted as a short term measure designed to stimulate aggregate demand. Public debate has also started on long-range tax reform and the need for establishing fair share and minimum tax levels for giant corporations. It is also expected that consideration will be given to a graduated tax on corporations to strengthen small and medium size companies and provide incentive to discourage monopoly.

However, these reforms and standard policies are for the most part aimed only at treating the symptoms of our economic maladies and never attack the real causes. It is now predicted that unemployment will reach decreased levels in the near future, however even if these levels are reached the economy will still be subject to wide swings in business mood. Monetary and fiscal policy dampen these cyclical swings but still leave us on the same roller coaster. For this reason the Human Investment Tax Credit is proposed as a measure which attacks inflation and recession at its roots, while simultaneously correlating aggregate demand, economic expansion, full employment and price stability.

EXECUTIVE OVERVIEW

EXECUTIVE OVERVIEW

by

L.V. Watkins, Robert Edmonds and Mark Goldes

A Human Investment or Employment Tax Credit is proposed to create a new fiscal policy tool designed primarily to increase private economy employment, thereby reducing the political demand for increased stimulative federal deficits and increased monetary stimulus which would lead to inflation. It offers major incentives to employers specifically designed to provide multiplied benefits to employees. It provides features which would stimulate the production of housing, energy and other private goods and services in a manner consistent with achieving a stable economy.

Solving the problems of unemployment and recession without creating further inflation, requires a fundamentally new approach. Although so designed that it should replace the capital investment tax credit, it accomplishes a number of purposes which the capital investment tax credit cannot do. Whereas a capital investment credit may be harmful to the economy, a human investment credit would dramatically reduce unemployment and be wholly beneficial.

This new approach offers the greatest benefits for the costs involved. It will induce and facilitate structural changes in the private economy that will improve its operating effectiveness. If enacted during a period of underemployment, it would facilitate transition to a full employment economy.

A. Problem:

It is now evident that inflation will continue at a substantial rate and unemployment will reach unusually high levels during 1975 and subsequent years unless there is major adjustment in national policies. Most economists and other observers including the administration's primary economic advisors are now aware that existing monetary and fiscal policy programs have carried us about as far as we can go in achieving full employment and price stability.

Present policies are based on quantitative growth through a preferential treatment of capital which require increasingly greater quantities of capital to sustain growth. In times of limited raw materials, limited capital and major shifts in demand, these policies result in significant misallocation of land, labor and capital resources.

With the U.S. facing a shortage of raw materials and feeling the limiting effects of non-renewable resources, a new economic policy is needed which provides for structural changes sufficient to increase economic expansion and employment without generating excessive inflationary pressure. The objective of the new policy needs to be people centered qualitative growth based on maximizing human capital, expanding free enterprise and private property founded on personal effort, improving the utilization of non-renewable resources and protecting the environment.

B. Action Needed

There appears to be an increasing realization that tax policy holds the key to short-run needs and the long-term removal of structural inequities. Similarly, it is recognized that tax policy can have major impact by stimulating:

1. More effective utilization of human resources.

2. Expansion of the base for savings and investments.

3. Private initiative and the flexible utilization of innovative technology.

4. New employment, directly rather than by continuing to use an indirect and possibly harmful route thru investment tax credits.

5. Accelerated production of needed goods and services such as housing and energy.

6. Correlation of training with direct economic and employment expansion.

An emergency tax cut has already been enacted to meet short-range needs. Public debate has also started on long-range tax reform and the need for establishing fair share and minimum tax levels for giant corporations. It is expected that consideration will be given to a graduated tax on corporations to strengthen small and medium size companies and provide incentives to discourage monopoly concentration.

However, not enough attention has been given to long-term tax adjustments that could correlate aggregate demand, economic expansion, full employment and price stability. This document is intended to encourage such a discussion by proposing a human investment or employment tax credit to stimulate increased employment and production.

C. <u>The Human Investment or Employment Tax Credit:</u>

The proposed human investment tax credit consists of the following elements:

1. A $1,000 per person credit to employers for hiring additional people. This credit would be $1,500 per person where individuals hired are under 20 years of age.

2. A $500 maximum tax credit per person to provide a Workshare bonus

to employees who accept short work weeks to spread available employment.

3. A $500 credit to corporations to match or stimulate expanded equity ownership by employees.

4. A $2,500 maximum tax credit for self-employed individuals to balance self-employed and corporate tax deferred retirement incentives.

5. A $500 per person credit to employers for utilizing approved training programs to improve job related skills of new and existing employees.

This multi-part tax credit is proposed to foster investment by employers in their employees, and economic stability for self-employed persons, in order to increase employment opportunities, expand savings and equity ownership and improve training opportunities. Congress might wish to set maximum credits that could be claimed by corporations or individual employers under these provisions.

The Human Investment Tax Credit is also proposed as an alternative to the capital investment tax-credit as well as a means of reducing the burdens of unemployment compensation and public service jobs.

The necessity for employers to have an alternative to the capital investment tax credit includes the following considerations:

1. The capital investment credits do not directly assure increased employment. They could increase unemployment by substituting machines for people, leaving the social cost of unemployment to increase while being ignored in the private investment decision.

2. If an artificially stimulated capital demand results, it requires more capital than labor expansion. Capital appears short at todays prices and additional demands may be inflationary and wasteful. In addition the creation of new capital under present inflationary conditions may not be required when a stable economy is attained. Furthermore, on the average,

we are now utilizing only about 70% of capacity and surplus or excess capability is appearing under more and more circumstances due to recession conditions.

3. There are millions of small employers and professional people whose capital investment needs are not directly related to increased employment. For these small employers the paperwork required as a result of hiring one or two additional people, without counterbalancing incentives, may frequently make the expansion of employment less desirable than business potential would indicate and allow.

4. The evolution of the economy toward services indicates that major potential for employment expansion may not be directly related to physical capital investment needs. Nevertheless the high overhead and operating cost of services requires incentives to encourage additional equity financing, expanded operations and the training of personnel.

5. The relative insignificance of past capital investment tax credits in relation to <u>much larger</u> capital investments supports doubt that the credits have any demonstrable effect upon either investment or increased employment. It appears likely that the capital I.T.C. is a short-term profit bonanza for a small segment of the economy. Because of potentially widespread application throughout business, <u>any</u> tax reduction would draw political support from business. True economic justification however seems non-existent.

The need for alternatives to the Capital Investment Tax Credit, unemployment compensation, and public service jobs is more humanely met by the proposed multi-part Human Investment Tax Credit. Each element of the Human Investment Tax Credit is described below in more depth to enable more adequate discussion of this approach as an alternative

to the capital investment tax credit.

1. <u>Increased employment incentives</u>.

To encourage employment, every employer would be allowed a tax credit of $1,000 per net new employee (aged twenty or more) hired in 1975 above the average number of employees working more than 300 hours during the last quarter of 1974. Full credit would be allowed for employees who have worked at least 1000 hours during the year. Credit for employees working less than 1000 hours shall be calculated at a rate of $1.00 per hour provided they work at least 500 hours at a rate of at least 28 hours per week. All subsequent years would be credited on the basis of the average number of employees working at least 1000 hours the preceding year.

Because of the general skills level of many teenagers is not adequate to earn minimum legal wages, the above $1,000 credit is increased to $1,500 for new employees who are less than twenty years of age. This provision in concert with training programs and credits should facilitate expanded employment for that sector of the population which has the highest unemployment rate with consequent adverse social effects. It is possible that Congress might wish to treat such employees as "new employees" during two consecutive years, for a period up to twenty-four months.

The credit may be deducted directly from 1975 tax liabilities, or if the tax credit exceeds liabilities, the excess credit may be carried back one year and forward three years. All credit taken must be consistent with employer tax reports filed during the year with the IRS.

Where mergers occur, the new company would have to establish the employment base of both merged firms as the point of reference for calculating the net new employment base of both merged firms for the purpose

of this credit.

The employment incentive is based on the following premises:

a. The simplest and most logical inducement to increased employment is a direct incentive for more people to become employees and for all employers to hire more employees. It can be assumed that there are always some marginal employment and growth decisions that can be affected if the incentive is adequate.

b. It would encourage the formation of new types of businesses or expansion of existing one to meet service needs such as health, child care, and care of the elderly.

c. In times of recession wages are sticky downward and new employment can be encouraged by providing employers with a subsidy differential between money wages paid and real or earned wages which are frequently lower than money wages.

d. When approaching full employment, employers will have incentives to hire less skilled employees and upgrade them, thus reducing structural and hard core unemployment.

e. The loss of employment due to federal minimum wage laws is counteracted by providing necessary incentives to offset costs incurred.

2. Workshare Bonus.

An additional element of this proposal is a Workshare Bonus. This provision enables and encourages both employers and employees to voluntarily reduce the work week to 32 hours or less where this is feasible and where new employment would thus be generated or where potential unemployment would be lessened. The Workshare Bonus is designed to provide partial unearned compensation for those who work 4, 3, or even 2 day work weeks

instead of the normal 5 days. We suggest a basic bonus rate of 5% for a 4 day week, 10% for a 3 day week and 15% for a 2 day week. Over a 6% rate of registered unemployment these percentages should be increased by 50% and over 8% unemployment the rates should be doubled.

This is based on the following premises:

a. This would provide a means and incentive for employees to assist in the more rapid assimilation of unemployed back into the work force.

b. It offers a basis whereby those most desirous of shorter working hours would voluntarily absorb a substantial portion of the unemployment burden.

c. More free time is made available for utilization of consumer goods.

d. Increased family time together with adequate employment backup could prove a partial answer to many of our most serious social problems.

3. Expanded savings and investment incentives.

In order to encourage savings and investment that provide jobs directly, each employer would be allowed up to a $500 tax credit for each employee who matched that amount to purchase at least $1,000 worth of equity in the employing company. The purchase could be for cash or could be financed by credit. The purchase price of the stock would have to be within 10% of the market price at the time of purchase and could not be resold for a period of perhaps 1, 2, or even 5 years.

The employers contribution, instead of being deducted as an ordinary expense of the business before income taxes, would be deducted from income tax liability itself. This would create a strong tax incentive to employees

to save by purchasing stock in the company, thereby providing new equity capital to strengthen the company and facilitate sound expansion. Subsequent use of the credit should be dependent on retained ownership by the employee. Insurance provisions similar to those existing in the lease guarantee program whereby private insurance is reinsured by a federal agency can protect the employee against any undue risk. It would be necessary to set limits to total credits used under this provision so as to balance benefits to estimated revenue losses.

This element of the proposal is based on the premise that broadly owned savings are necessary:

a. To facilitate investment for capital and employment expansion.

b. To stimulate increased productivity by employee-owners through creative interactions with management.

c. To moderate wage demands under circumstances of potential inflation.

d. To facilitate capital acquisition and continued economic expansion during times approaching full employment.

4. Self-employment incentive.

In order to encourage self-employment and the additional investment needed for self-employment, each self-employed individual would receive up to a $2,500 tax credit against his tax liability. Increased necessary business regulation has made it more difficult for individuals to become and remain self-employed. Each person who makes the transition leaves a job opening for another person and takes the first step toward hiring others later as employees.

One primary reason for this provision is that virtually every employee and self-employed person is now eligible for tax deferment on that portion of his income that is separately set aside for future retirement. Yet

most small businessmen are short of capital and need all the savings they can accumulate to finance their own businesses. They therefore have no surplus funds to take advantage of tax deferred retirement provisions. Such businesses are their owners' retirement assets. This provision therefore allows equitable consideration to be given to the retirement needs of those self-employed individuals whose retirement assets are currently being accumulated and used to give employment and self-employment.

Limits established under this provision should be consistent with other retirement legislation. The current limit of $7,500 appears to be applicable to only a very few high income professional people. It would be more equitable to allow self-employed individuals to defer $2,500 annually for equity assets with the remainder of the $7,500, if any, to be deferred in the same way as for other employee retirement provisions.

When a business is sold, that portion of assets which had been accumulated on a tax deferred basis should be convertible into a conventional retirement plan. This would further defer tax liability until retirement income is received.

This element is also based on the premise that self-employment is consistent with increased productivity, innovative economic expansion and price stability.

5. <u>Improved training incentives</u>.

In order to encourage employment and the correlation of employment with training capability, each employer would be allowed a $500 credit for utilizing approved training activities for new and existing employees in order to improve their job related qualifications and skills.

Eligibility for this credit would require certification by the State

Employment Services in accordance with criteria established by the federal government. This certification would assure the appropriateness of training for available employment, the fulfilment of performance requirements and the commitment of the company toward upgrading its people. Cross-training would be prohibited except where necessary for specific positions.

This element is based on the following premises:

a. Employment expansion and increased productivity are limited by the difficulty of matching qualified, trained personnel with employment opportunities.

b. The federal government is financing manpower programs which are now of limited effectiveness due to the lack of inducement for concerted action by the employer, employee, and the employment service.

6. Cost of the Human Investment Tax Credit.

The proposed tax credit would reduce income to the federal government and increase deficits if other compensating factors were not present. It is certain, however, that its implementation will reduce other government spending and produce additional government income.

Arthur Okun has observed that a 1% decrease in unemployment increases real national product by 3%. Even assuming this to be high it is logical to infer that a reduction of unemployment from 8% to 3.5% under full working hours conditions would contribute between 125 and 175 billion dollars annually to the GNP and thus contribute significantly to government revenues. Simultaneously it could virtually replace present expenditures of $13 billion for unemployment compensation, $4 billion for capital investment tax credits and $4 billion for public service jobs. In addition it would help to eliminate waste and make more effective some $10-12 billion spent for manpower training programs.

In estimating cost directly for each element of the Human Investment Tax Credit the following computations are put forward for discussion purposes:

a. Employment incentives of $1,000 per person for some 4 million individuals that need to be drawn into the work force to reduce unemployment to 3.5% would cost $4 billion. Assuming approximately 1 million of the new employees would be individuals under age 20, the total cost for this element would increase from $4 billion to $4.5 billion.

b. An estimate of the Workshare Bonus cost is calculated on an assumed 5 million employees willing to reduce their work time by one day drawing an unearned 10% bonus of wages throughout the full year. At an average annual full time wage of $8,000 ($4 per hour for 2000 hours) this would amount to $4 billion. This amount is far less than the cost in unemployment compensation if the reduced labor time prevents prospective or current unemployment.

c. Expanded saving and investment incentives are going to have a cost that is more difficult to estimate. If 18 million employees (under 20% of the total and about 65% of a recent estimate of U.S. shareholders) participated, the cost could be estimated at $9 billion. If matching requirements were 1 for 1 the incentive would generate $18 billion in employee equity investments. If the matching requirement was set at 2 employee dollars for each incentive dollar then equity investment would increase to $27 billion. If the matching requirement was set at 3 employee dollars for each incentive dollar then employee investment would increase to $36 billion dollars. There would be a multiplier effect of some unknown magnitude in meeting capital needs of business.

d. Self-employment incentives would cost approximately $9 billion assuming some 6 million self-employed individuals would claim average credits of $1,500 each, which is 60% of the maximum.

e. Improved training incentives would cost another $3 billion assuming a maximum of 6 million individuals would be trained and their employers thus made eligible for this credit.

It is easy to see that these estimates are high and could be expected to be substantially less. It is worth noting, however, that the $29.5 billion price tag would be offset by reduced unemployment compensation and public service employment expenditures as well as lost revenues saved by other tax changes. In addition tax revenues would be increased by an unknown amount due to the additional GNP induced by these credits.

D. Summary.

A new approach is needed if we are to solve the problems of inflation, recession and unemployment. The capital investment credit offers less benefits for the costs incurred than would a human investment or employment tax credit.

With adequate support to expedite the work involved, the human investment tax credit program could be rapidly instituted. We hope such support can be found without delay.

WHY THE HUMAN INVESTMENT TAX CREDIT?

by
L.V. Watkins*

It is now evident that inflation will continue at a significant rate and unemployment will reach unacceptable levels during 1975 and subsequent years unless there is major adjustment in national policies. Most economists and other observers including the administration's primary economic advisors are now aware that the manipulation of monetary and fiscal policy program has carried us about as far as we can go in achieving full employment and price stability.

It is also increasingly evident that monetary and fiscal tools, designed to offset private economic distortions, have contributed significantly to large government spending, large deficits, excessive price inflation and a new type of cyclical fluctuation. The prevailing analytical framework is therefore considered inadequate (1) to understand our current inflation-unemployment problem, and (2) to create policy measure for dealing wiht the problems.

Consequently, a new economic policy is needed. Since the U.S. is, for the first time, facing shortages in some basic raw material and non-renewable resources, the new policy must seek ways to introduce structural changes sufficient to increase economic expansion and employment without generating excessive inflationary pressure. These structural changes must be directed at reducing friction in production and employment and encourage wage and price levels consistent with a stable economy.

*Incorporates material prepared in cooperation with Robert Edmonds and Mark Goldes .

To ascertain the most effective structural changes needed, a comprehensive research proposal has been recommended to diagnose major structural deficiencies, hypothesize a new way of viewing the economy, and formulate new policies to overcome defects. This paper is designed to show only major defects that relate directly to the need for the human investment tax credit.

A. The Posture of Keynes

The late John M. Keynes has been the most influential contributor to present day economic policies and programs. Increasingly two of his major contributions have been singled out for their far-reaching importance. These contributions are:

1. The diverting of policy makers attention from redistribution of wealth to increasing total production of all members of the economy.
2. The recognition that increased output was subject to and significantly dependent upon public action.

Prior to Keynes, Adam Smith's invisible hand had governed economic thought for over a century. The concept of automatic self-adjustment according to immutable laws of nature had presumably protected the best interests of a free society. The high mass unemployment of the thirties presented a serious challenge to this concept which was squarely met by Keynes. Keynes argued that the depression was man-made and called for deliberate public action to stop the waste of human resources represented by unemployment.

In addition, earlier economists were inclined to treat the nation's output as having a given size (a pie of fixed dimensions). Under such circumstances, any gain by one individual or group should by necessity constitute a loss to others. This concept concluded that conflict of interest was inevitable and precluded cooperation. Keynes, however,

argued that the pie was not fixed in size and that more could and would be produced if unemployed people and other resources were usefully occupied.

These contributions were significant in the context of the 1930's, but most now question the current relevance of Keynes' definitions and inferences. They also question the limited analytical framework that evolved from those definitions and the current applicability of policies and programs derived therefrom.

Reflection reveals the general acceptability and a certain applicability of Keynes' recommendations to the decades between 1930 and 1960. During this period, however, his analytical framework and policies became conventional wisdom and now ironically, they require challenging with the same energy with which he challenged the relevance of conventional economic thinking in his day.

To do this, it is necessary to attack squarely the generally accepted underlying premises of Keynesian economics. These underlying premises are primarily:

1. The essence of economic progress as an ever larger pie with bigger and bigger shares for all. This concept infers that growth is one dimensional, quantitative, infinite, with full resource utilization, and shareable in fixed proportions. It does not take into consideration the multidimensional qualitative aspects of human needs, monopoly pricing or control of resources, or limited non-renewable resources. Nor does it take into consideration the resulting impact on the environment or future growth, the allocation of benefits,

the distribution of social cost, or degradation of the ultimate resource of human life.

Likewise, it infers a multidimensional disequilibrium - a maximizing of one dimensional needs satisfaction rather than a balanced satisfaction of needs and aspirations in various dimensions. The physical, organic, psychological and spiritual dimension within the individual must be balanced in a manner similar to the equilibrium of an ecological system.

2. Utilization of the money illusion as the appropriate means of reducing real wages and providing full employment. This concept accepts the definition of economic progress as continuous quantity growth and infers that nothing short of full utilization of human and non-human resources can accomplish adequate growth rates. It also infers the necessity of inflationary public policy to stimulate aggregate demand and price increases to insure full resource utilization.

   On reflection, it is evident that there is nothing inherently desirable in full utilization of resources unless they serve to produce needed goods and services. If greater production is necessary merely to accomplish full employment, the natural relationship between production and consumption is reversed - production and resource utilization become the needs and consumption the means. More can be employed only if more is consumed and a vicious cycle is created and perpetuated. If satisfaction of human needs is the ultimate goal, increased growth just to provide people with work does not make sense unless the goods and services produced are needed for consumption. The

objectives of work to justify distribution of income and purchasing power could be more desirably accomplished by restructuring the production function. The concept also infers that a public policy which seeks price stability, without major institutional change, would automatically decrease employment, due to reduced labor demand at institutionally supported prices. On the other hand, inflationary policies under conditions of limited renewable resources and indexed wage rates would compound institutional inequities.

3. The utilization of general monetary and fiscal policy as the appropriate tool to increase aggregate demand and manipulate private savings and investment to meet desired growth and employment needs. This concept accepts the definitions of economic progress as growth and full resource utilization and implies that quantitative policies to stimulate aggregate demand and price increases are necessary to maintain needed growth and employment. By contrast, consideration of multidimensional, qualitative human needs, monopoly pricing, limited non-renewable resources and resource conservation results in the emergence of a needed qualitative policy component.

4. The distribution of wealth does not adversely affect the quantity and rate of growth if excess savings is offset by appropriate public monetary and fiscal action. As accepted, this concept infers that the objective, purpose, and form of the above Keynesian definitions and policies are both appropriate and adequate over the long run. This concept could not stand without an almost total preoccupation with size and growth in

aggregate production and conversely with neglect of its composition and distribution of its component parts. This approach was preferable to both public and private officials because it was easier and required less institutional change than policies of reallocation and redistribution of wealth and income.

This paper not only challenges these basic premises of Keynesian economics but also recommends alternative action to meet some of the deficiencies.

B. The Illusion

Keynes' preoccupation with quantitative consumption and capital growth led him to believe that in the short run, both consumption and capital expansion could be increased by government policies to increase aggregate demand and employment.

In deriving his policies, Keynes recognized the sticky nature of wage rates during recession and depression and rejected the assumption that the supply of labor depended on real wages. He conversely assumed that labor was subject to money illusion and thus the supply of labor was a function of the money wage rate. Keynes therefore argued for public policies to increase aggregate demand and to raise prices sufficiently to reduce real wages.

In reality, Keynes assumed labor was like a herd of sheep waiting for public officials to create the illusion of calling them into action. Through public policies aimed at increasing aggregate demand, inflation would create the illusion by increasing both prices and wages. It assumed that prices would rise faster than wages, thus altering the relative cost of factors of production. With money wages rising, labor

would respond to employment opportunities stimulated by increased aggregate demand. Since the returns to capital would be rising faster than wages, the relatively higher marginal value product of capital would stimulate capital investment to sustain growth and increase employment. The consumption for production treadmill was thus in operation. No consideration was given to the possibility of institutional or resource restraints causing significant price increases to offset stimulated demand prior to full employment.

Keynes advocated the use of monetary and fiscal policies as companion tools to stimulate aggregate demand. Analysis reveals however, that they have different impacts on factors of production. Public expenditures stimulate demand directly causing prices to rise faster than wages. This increases the average value product or return to capital. The overall effect of public spending depends on whether it is accompanied by public deficits or public surpluses and the economic conditions of the times. Deficit financial expenditures generally (at times other than deep depression) tend to increase interest rates and the cost of capital. This lessens the profitability of capital investment unless offset by increases in the money supply.

On the other hand, an increase in the supply of money generally reduces the interest rate in the short run, thus reducing the cost of borrowed capital and increasing the rate of return (profits) for business relative to labor unless offset by excess government spending.

Both tools thus give a preferential treatment citizenship to capital and when coupled with capital gains and capital investment tax credits creates an economy dependent on increasingly larger aggregations

and increasingly greater government action to maintain production, employment, and consumption.

Why haven't economists more clearly analyzed this problem? They have also become victims of this illusion by:

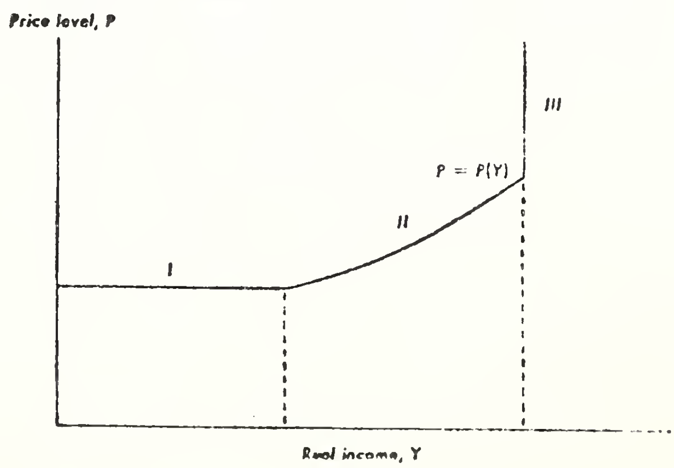
1. accepting uncritically the central concept of quantity growth,

2. stumbling into the quagmire of policy dogma and techniques.

This can readily be seen in the following excerpt from a recent Brooklings Institute publication:

> "It is often supposed that the aggregate supply function is flat at relatively low levels of 'Y'; then begins sloping upward as 'Y' passes through moderate and high levels of capacity utilization; and finally becomes vertical at full utilization of resources. Such a schedule is depicted in Figure 5, where the three ranges are labled, I, II, and III, respectively.
>
> "If the figure gives a reasonably accurate picture of the world-and eclectic Keynesians have often supposed that it does--then the crude Keynesian case appears as region I, where it is correct to view the price level as fixed. Similarly, region III, where it is correct to view real output as fixed, corresponds to the monetarist case; in the Keynesian literature this is often called 'pure price inflation'. The intermediate case, region II, where each increment of real output can be achieved only at some cost in terms of inflation, corresponds to the eclectic Keynesian position that underlies the Phillips curve. If Friedman is correct, as we believe he is, in directing his fire at the large number of Keynesian economists who have focused myopically on region I, then the majority of the profession is also correct to fault the monetarists for concentrating unduly on region III."

A Possible Aggregate Supply Schedule, $P = P(Y)$



Further clarity is made possible by looking at the analytical techniques of fiscal and monetary policy advocates:

The literature on measuring fiscal influence which is primarily "Keynesian", has been developed incorporating a number of limitations that only occasionally appear to be recognized or explicitly acknowledged.

1. The price level has been ignored, or, at best, treated as an exogenous variable that moves independently of government policy. On the other hand, attempts to account for change in the price level have been relatively unsuccessful.
2. In general, monetary effects have been omitted from the analysis. Few studies spell out a set of assumptions about monetary policy. Some seem to require that monetary policy stablize the price level. Others require that it stabilize interest rates. Unfortunately, it cannot normally do both.
3. Attention has been focused on the implications of changes in the level of aggregate demand (income effect). The implications of relative price changes (substitution effects) that may be caused by fiscal policy are largely ignored.
4. The institutional impact or effects have been ommitted from analytical consideration.

Likewise, the literature of monetarists (a form of modified "Keynesian economics") also reflects similar limitations:

1. Aggregate price levels, in recent times, are given overriding consideration.
2. In general, fiscal policies are considered impotent.
3. Attention has been focused on the implications of relative price changes (substitution effect) that may be caused by monetary

changes (substitution effect) that may be caused by monetary policy.

4. The institutional impact or effects have been omitted from analytical consideration.

More and more members of the Economics profession are coming to realize that past doctrinal orientation and inadequate forecasting techniques have complicated economic progress in the United States. Most of their conflicting policy recommendations, however, have become institutionalized and have propagated the debate presently raging in the Congress and public media. This debate was highlighted by a recent Washington Conference as follows:

1. A Harvard professor and numerous financial officials are stressing the prospects of a severe capital shortage over the next five to ten years.
2. A Federal Reserve Board economist argues that the Federal government must run annual deficits of $35 to $40 billion on a continueing basis or the economy will not grow. This is necessary he feels to facilitate growth in the private sector.
3. The Secretary of the Treasury argues that financing the public deficit will crowd private demand for funds out of the money market in the short run. Others argue that this will happen only after twelve months.
4. There is agreement that the potential shortage of investment funds poses a threat to the future economic growth rate. An alternative solution through a reduction of taxes on business, which is in part a mirror image of deficient capital spending, is called for.

5. Some public and private officials call for expanded money supply and government intrusion with direct financing to re-liquify the private enterprise system.

6. Still others argue that deficits and government action on finances of first resort rather than last resort marks the end of the enterprise system. This group recommends tax reform for business and improved capital depreciation allowances.

All represent aspects of conventional economic wisdom which accepts geometric growth as necessary and citizenship to mass capital, mass organization and mass governmental action.

Assuming for the sake of presentation, that public officials, by accident or by enlightened economic counsel, prescribed the optimum fiscal and monetary policy mix, the question remains: Will that mix provide significant output at reasonable levels of inflation and unemployment? We believe it will not without major institutional restructuring.

C. Stating the Case

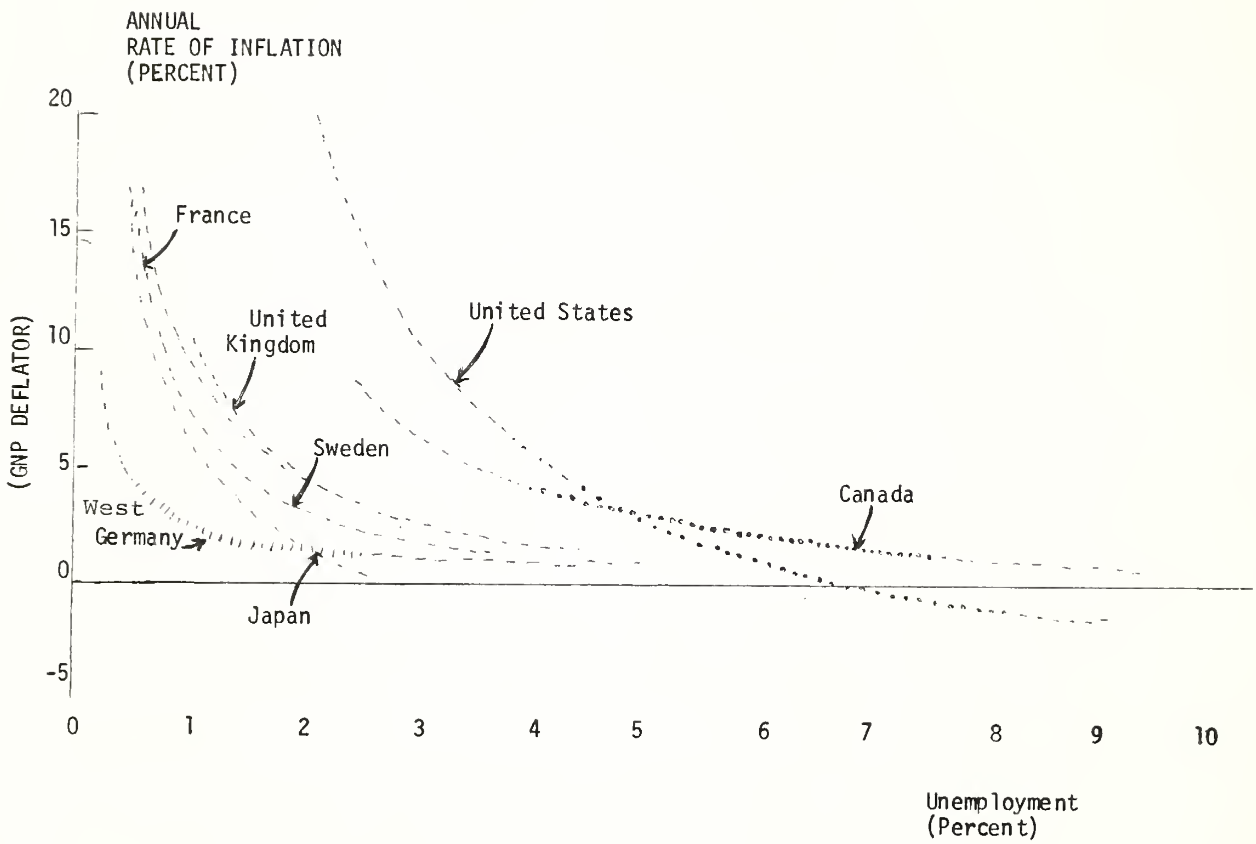
The above statement was made after evaluating the structural relationships in various free market countries. This evaluation is also reflected in the chart on Page 28 which displays comparative Phillips Curves for seven countries.

The U.S. economy, when compared with those of other industrial countries, generates excessive inflation at a higher rate of unemployment. In addition, recent evidence indicates that the Phillips Curve for the United States has shifted considerably more to the right in the last two years.

The Phillip's curve reflects the interrelationship between aggregate demand, unemployment and inflation. Higher rates of aggregate

STEADY STATE RELATION BETWEEN

INFLATION AND UNEMPLOYMENT



demand will reduce unemployment at a cost of higher inflation. Lower rates of inflation can be accomplished at a cost of lower aggregate demand and higher unemployment.

To understand our dilemma, we must determine what influences the position and slope of the Phillips curve. We suggest that they are influenced by the institutional interrelationships between factors of production, aggregate demand and the distribution of income.

Primary institutional relationships include:

1. Index clauses in labor contracts, social security, and other retirement and income maintainance program which seek to affect or exceed inflation.
2. Large scale organization and technology not conducive to rapid resource adjustment in response to demand shifts.
3. Structural unemployment due to changes in demand and automation.
4. Monopoly control of price, especially in cases of limited non-renewable resources.
5. Capital structure and ownership that perpetuates concentration of wealth.
6. Inappropriate investment (misallocation of capital) due to concentration of wealth.

To clarify the case, we need to look at some of the specific relationships and the general functioning of the economy.

Present policy was initiated to deal with a depression which was characterized by excess capacity and sticky downward wage rates. By stimulating aggregate demand, prices would rise reducing the real wage rate and pulling factors of production into a more competitive relationship, furthering the real expansion of the economy. The basis of this policy is what Keynes called the money illusion.

Through time, unions and other sectors of the economy grew wise to the illusion and opted for higher real wages at the cost of some employment. To assure this, they instituted cost of living increase clauses into union wage contracts. The widespread use of such clauses sought to assure a consistent or increasing real wage. Similar clauses have been included in legislation to protect government retirement and social security benefits against inflation.

Under these conditions, theoretically, employment tends to decline in unionized areas with employment increasing in the non-union sectors. This would happen, however, only under conditions of pure competition and full employment.

The response of the economy as a whole to inflationary stimulation is further conditioned by the prevalence of industry concentration and oligopolistic pricing policies, (both in national and international markets). The results of these institutional distortions from purely competitive standards is additional inflation and further loss of efficiency in the social allocation of resources.

What happens if we do not have an economy that is purely competitive and running at full employment? Traditionally we have used government action to stimulate aggregate demand. But now, we cannot expect equilibrium at full employment, nor can we expect the marginal cost of factors of production to be equal. Inflationary forces through stimulated aggregate demand will not reduce real wages. The new equilibrium will be at the level of employment which equates the marginal cost of factors of production with real wages. Anything beyond that point constitutes pure inflation.

With less than full employment, institutionalized government policy must now be constantly used to stimulate maximum growth that will enable net new income to be distributed to the unemployed and underemployed sector of the economy. New private employment can only take place in natural growth sectors not offset by new technology or in new demand areas generated by new tastes or new technology that are not substitutes.

Traditional government policy has some advantages under these conditions. Action to stimulate demand helps maintain growth while inflation coupled with the progressive income tax helps insure that government will

automatically get a larger share of the pie to redistribute through government programs and maintain growth. With unemployment institutionalized, however, government expenditures generally exceed revenues and increase inflationary pressures.

Consequently private and social overhead costs increase significantly and will continue only as long as there are no limits on quantitative growth which distort relationships between factors of production or stimulate major shifts in demand. Under these conditions, major reallocation of capital is necessary while at the same time government must be more dynamic in reallocation of benefits or in modifying the relationships between factors of production. In economies which have given preferred treatment to larger and larger units of capital these reallocations become tougher and tougher. Time also becomes more of the essence. Delayed action either produces rampant inflation or rampant unemployment or both.

The economy thus becomes increasingly vulnerable to shock waves which stimulate additional government action to avert "major recession". This strategy, by necessity, involves a long-term increase in social debt which is paralleled by a decline in individual and corporate liquidity. The system appears to be living on borrowed time and borrowed capital. The key questions then start coming into view.

To put this in a greater perspective, we will try to examine the impact of government fiscal and monetary policy during conditions of inflation and unemployment. Unlike times of stable or declining prices, government action intended to increase aggregate demand and employment during times of inflation puts immense pressure on private savings and investment.

Government fiscal and monetary policies increase the demand for

private investment in the private sector, and for private financing of public deficit bonds. At the same time, the policy also perpetuates and accelerates increases in prices and wages which:

1. Lower the real value (transaction effectiveness) of an unchanged money supply.
2. Depress exports and induce imports thus reducing money supply.
3. Increase tax receipts, assuming a progressive income tax, at all levels of real wages thus further reducing the money supply.

The supply of money is thus decreasing in real value terms if not in actual terms. This becomes more significant when we consider the impact of the level and concentration of wealth on savings and investment.

The real income and wealth of the country decline during a recession or depression when total output declines. This is compounded when inflation further reduces profit and stock prices as well as when it reduces the real value of public and private debt held by the private sector. Wealth is further decreased when imports exceed exports and is usually further concentrated when rises in price are influenced by resource shortages. The full impact of rising prices on the supply of money private savings and investment can only be seen through an analysis of wealth concentration. Yet, conventional economic Viewpoints largely ignore the effects of wealth concentration. In the words of a leading monetarist,"I haven't studied the concentration of wealth-- but I don't think it's important."

It is clear, however, that the demand for money is going up at the very time that the value of the money supply is going down. Consequently, within the private economy, there are savings-investment imbalances that

are too great to be offset by Keynesian derived programs of monetary expansion and deficit spending. This paradox can be overcome only by one or a combination of the following:

1. Increase the rate of personal savings. This would require an increase in interest rates as an incentive to decrease consumption and increase savings. This would decrease aggregate demand and reduce the effect of fiscal policy.
2. Increase the inflow of foreign investment funds. This would significantly alter the present ownership pattern of American industry.
3. Increase the creation of new money by the Federal Reserve System. This would obviously increase the rate of inflation significantly.

Regardless of the approach, it is still doubtful that the federal deficit for the next two years can be financied without displacing private investment needs and aborting the economic recovery. This assumes of course, the Nation's continued commitment to quantifying growth through larger and larger increases in physical capital.

Recent studies by Norman B. True, a Washington Consultant and Allen H. Meltzer, Carnegie-Mellon University, indicate that to meet the needs of the next two years; (1) Personal savings would have to increase from approx. 5% to 12% and interest rates to nearly 20%, (2) Foreign inflow investment would have to triple, and (3) The money supply must increase by approximately 30 to 40 percent.

The effect on inflation is obvious. Also we are not likely to meet these figures or any close to them. Assume however, that the needs of

the next year are met. The chances of meeting the needs of the next ten years seem far more unlikely. Recent estimates published by Chase of New York and Secretary of the Treasury Simon, indicate that some $4.1 trillion in capital is needed to sustain U.S. growth and employment during the next ten years.

These projections of course, continue to accept the concepts of quantitative growth based on mass capital, mass organization, and mass government action which assumes: (1) unlimited capital, (2) unlimited nonrenewable resources and (3) unlimited flexibility in the resource market. It should be clear by now that capital has both qualitative and quantitative limits. It should be even more evident that limited non-renewable resources are presently a reality, and that inflexibility in the resource market will continue to plague us in the future. With these limitations, is it not also evident that we must abandon the commitment to geometric growth of physical capital?

If we are to abandon the above commitments, the question becomes - What should our objectives and premises be? We suggest that the objectives should be people centered qualitative growth based on the following: (1) maximizing human capital, (2) expanding free enterprise and private property founded on personal effort, and qualitative utilization and conservation of nonrenewable resources and the environment.

These objectives will enable us to put to maximum use existing excess capacity and unemployed human resources in order to recover from the present recession. In addition, future growth should take directions consistent with maximizing human capital and qualitative physical capital in proportions that would be significatnly more consistent with national financing capability.

This type of policy is needed not only to deal with present capital shortages, inflation, and depression conditions. It is also needed to help with long range adjestments evolving from the following conditions identified by James O'Toole of Oxford University:

1. A continuing shortage and rising cost of energy causing increasing pressure to substitute labor for capital.
2. A continuing shortage of capital in our debt economy causing pressure for more labor intensive enterprise.
3. A continuing shift from an industrial based economy in the more labor intensive service economy.
4. A continuing pressure by environmentalists resulting in additional shifts away from capital intensive industry and an increase in labor intensive health, education, and other services, and
5. A continuing shift in the ratio of retired to those in the labor force resultin in an increase in dependency ratio.

All of these factors could result in lower productivity and economic growth unless public policy is developed to fit these trends into a restructured economic environment, one that is dynamic and capable of using to the maximum both human and physical capital.

At the present time there is little agreement among economists and public officials regarding the most effective policy and structural changes needed to implement such objectives, there is however, increasing realization that tax policy holds the key to short-run needs and the long-term removal of structural inequities. Similarly, it is recognized that tax policy can have major impact by stimulating:

1. More effective utilization of human resources.

2. Expansion of the base for savings and investments.

3. Private initiative and the flexible utilization of innovative technology.

4. New employment, directly rather than continuing to use an indirect and possibly harmful route through investment tax credits.

5. Accelerated production of needed goods and services such as housing and energy.

6. Correlation of training with direct economic and employment expansion.

Public debate has also started on long-range tax reform and the need for establishing fair share and minimum tax levels for giant corporations. It is expected that consideration will be given to a graduated tax on corporations to strengthen small and medium size companies and provide incentives to discourage monopoly concentration.

D. <u>A Component of Tax Reform</u>

Not enough attention has been given to long-term tax adjustments that could correlate aggregate demand, human resources, limited capital, economic expansion, full employment and price stability. It is our intention to encourage such a discussion by proposing a human investment or employment tax credit to stimulate increased employment and production.

The proposed human investment tax credit consists of the following elements:

1. A $1,000 per person credit to employers for hiring additional people. This credit would be $1,500 per person where individuals hired are under 20 years of age.

2. A $500 maximum tax credit per person to provide a Workshare bonus to employees who accept short work weeks to spread available employment.

3. A $500 credit to corporations to match or stimulate expanded equity ownership by employees.

4. A $2,500 maximum tax credit for self-employed individuals to balance self-employed and corporate tax deferred retirement incentives.

5. A $500 per person credit to employers to utilize approved training programs to improve job related skills of new and existing employees.

This multi-part tax credit is proposed to foster investment by employers in their employees, and economic stability for self-employed persons, in order to increase employment opportunities, expand savings and equity ownership and improve training opportunities. Congress might wish to set maximum credits that could be claimed by corporations or individual employers under these provisions.

The Human Investment Tax Credit is also proposed as an alternative to the capital investment tax-credit as well as a means of reducing the burdens of unemployment compensation and public service jobs.

The necessity for employers to have an alternative to the capital investment tax credit includes the following considerations:

1. The capital investment credits do not directly assure increased employment. They could increase unemployment by substituting machines for people, leaving the social cost of unemployment to increase while being ignored in the private investment decision.

2. If an artificially stimulated capital demand were to result, it would require more capital than labor expansion. Capital appears short at today's prices and additional demands may be inflationary and

wasteful. In addition the creation of new capital under present inflationary conditions may not be required when a stable economy is attained. Furthermore, on the average, we are now utilizing only about 70% of capacity and surplus or excess capability is appearing under more and more circumstances due to recession conditions.

3. There are millions of small employers and professional people whose capital investment needs are not directly related to increased employment. For these small employers the paperwork required as a result of hiring one or two additional people, without counterbalancing incentives, may frequently make the expansion of employment less desirable than business potential would indicate and allow.

4. The evolution of the economy toward services indicates that major potential for employment expansion may not be directly related to physical capital investment needs. Nevertheless the high overhead and operating cost of services requires incentives to encourage additional equity financing, expanded operations and the training of personnel.

5. The relative insignificance of past capital investment tax credits in relation to <u>much larger</u> capital investments supports doubt that the credits have any demonstrable effect upon either investment or increased employment. It appears likely that the capital I.T.C. is a short-term profit bonanza for a small small segment of the economy. Because of potentially widespread application throughout business, any tax reduction would draw political support from business. True economic justification however seems non-existent.

The need for alternatives to the Capital Investment Tax Credit, unemployment compensation, and public service jobs is more humanely met

by the proposed multi-part Human Investment Tax Credit. The premises upon which each element of the Human Investment Tax Credit is based is described below to enable more adequate discussion of this approach as an alternative to the capital investment tax credit and as a tool to further the objective of quality growth based on maximum utilization of human capital.

1. Increased employment incentives.

To encourage employment, every employer would be allowed a tax credit of $1,000 per net new employee (ages twenty or more) hired in 1975 above the average number of employees working more than 300 hours during the last quarter of 1974. Full credit would be allowed for employees who have worked at least 1000 hours during the year. Credit for employees working less than 1000 hours shall be calculated at a rate of $1.00 per hour provided they work at least 500 hours at a rate of at least 28 hours per week. All subsequent years would be credited on the basis of the average number of employees working at least 1000 hours the preceding year.

Because of the general skills level of many teenagers is not adequate to earn minimum legal wages, the above $1,000 credit is increased to $1,500 for new employees who are less than twenty years of age. This provision in concert with training programs and credits should facilitate expanded employment for that sector of the population which has the highest unemployment rate with consequent adverse social effects. It is possible that Congress might wish to treat such employees as "new employees" during two consecutive years, for a period up to twenty-four months.

The credit may be deducted directly for 1975 tax liabilities, or if the tax credit exceeds liabilities, the excess credit may be carried back one year and forward three years. All credit taken must be consistent with employer tax reports filed during the year with the IRS.

Where mergers occur, the new company would have to establish the employment base of both merged firms as the point of reference for calculating the net new employment base of both merged firms as the point of reference for calculating the net new employment for the purpose of this credit.

The employment incentive is based on the following premises:

a. The simplest and most logical inducement to increased employment is a direct incentive for more people to become employees and for all employers to hire more employees. It can be assumed that there are always some marginal employment and growth decisions that can be affected if the incentive is adequate.

b. It would encourage the formation of new types of businesses or expansion of existing one to meet service needs such as health, child care, and care of the elderly.

c. In times of recession wages are sticky downward and new employment can be encouraged by providing employers with a subsidy differential between money wages paid and real or earned wages which are frequently lower than money wages.

d. When approaching full employment, employers will have incentives to hire limited employees and upgrade them, thus reducing structural and hard core unemployment.

e. The loss of employment due to federal minimum wage laws is counteracted by providing necessary incentives to offset costs incurred.

2. Workshare Bonus.

An additional element of this proposal is a Workshare Bonus. This provision enables and encourages both employers and employees to voluntarily reduce the work week to 32 hours or less where this is feasible and where

new employment would thus be generated or where potential unemployment would be lessened. The Workshare Bonus is designed to provide partial unearned compensation for those who work 4, 3, or even 2 day work weeks instead of the normal 5 days. We suggest a basic bonus rate of 5% for a 4 day week, 10% for a 3 day week and 15% for a 2 day week. Over a 6% rate of registered unemployment these percentages should be increased by 50% and over 8% unemployment the rates should be doubled.

This is based on the following premises:

a. This would provide a means and incentive for employees to assist in the more rapid assimilation of unemployed back into the work force.

b. It offers a basis whereby those most desirous of shorter working hours would voluntarily absorb a substantial portion of the unemployment burden.

c. More free time is made available for utilization of consumer goods.

d. Increased family time together with adequate employment backup could prove a partial answer to many of our most serious social problems.

3. <u>Expanded savings and investment incentives</u>.

In order to encourage savings and investment, each employer would be allowed up to a $500 tax credit for each employee who matched that amount to purchase at least $1,000 worth of equity in the employing company. The purchase price of the stock would have to be within 10% of the market price at the time of purchase and could not be resold for a period of perhaps 1, 2, or even 5 years.

The employers contribution, instead of being deducted as an ordinary expense of the business before income taxes, would be deducted

from income tax liability itself. This would create a strong tax incentive to employees to save by purchasing stock in the company, thereby providing new equity capital to strengthen the company and facilitate sound expansion. Subsequent use of the credit shall be dependent on retained ownership by the employee. Insurance provisions similar to those existing in the lease guarantee program whereby private insurance is reinsured by a federal agency can protect the employee against any undue risk. It would be necessary to set limits to total credits used under this provision so as to balance benefits to estimated revenue losses.

This element of the proposal is based on the premise that broadly based savings are necessary:

a. To facilitate investment for capital and employment expansion.

b. To stimulate increased productivity by employee-owners through creative interactions with management.

c. To moderate wage demands under circumstances of potential inflation.

d. To facilitate capital acquisition and continued economic expansion during times approaching full employment.

4. Self-employment incentive.

In order to encourage self-employment and the additional investment needed for self-employment, each self-employed individual would receive up to a $2,500 tax credit against his tax liability. Increased necessary business regulation has made it more difficult for individuals to become and remain self-employed. Each person who makes the transition leaves a job opening for another person and takes the first step toward hiring others later as employees.

One primary reason for this provision is that virtually every

employee and self-employed person is now eligible for tax deferment on that portion of his income that is separately set aside for future retirement. Yet most small businessmen are short of capital and need all the savings they can accumulate to finance their own businesses. They therefore have no surplus funds to take advantage of tax deferred retirement provisions. Such businesses are their owners' retirement assets. This provision therefore allows equitable consideration to be given to the retirement needs of those self-employed individuals whose retirement assets are currently being accumulated and used to give employment and self-employment.

Limits established under this provision should be consistent with other retirement legislation. The current limit of $7,500 appears to be applicable to only a very few high income professional people. It would be more equitable to allow self-employed individuals to defer taxes on up to $2,500 annually for equity assets with the remainder of the $7,500 to be deferred the same as for other employee retirement provisions.

When a business is sold, that portion of assets which had been accumulated on a tax deferred basis should be convertible into a conventional retirement plan. This would further defer tax liability until retirement income is received.

This element is also based on the premise that self-employment is consistent with increased productivity, innovative economic expansion and price stability.

5. Improved training incentives.

In order to encourage employment and the correlation of employment with training capability, each employer would be allowed a $500 credit for utilizing approved training activities for new and existing employees

in order to improve their job related qualifications and skills.

Eligibility for this credit would require certification by the State Employment Services in accordance with criteria established by the federal government. This certification would assure the appropriateness of training for available employment, the fulfilment of performance requirements and the commitment of the company toward upgrading its people. Cross-training would be prohibited except where necessary for specific positions.

This element is based on the following premises:

a. Employment expansion and increased productivity are limited by the difficulty of matching qualified, trained personnel with employment opportunities.

b. The federal government is financing manpower programs which are now of limited effectiveness due to the lack of inducement for concerted action by the employer, employee, and the employment service.

E. Cost of the Human Investment Tax Credit.

The proposed tax credit would reduce income to the federal government and increase deficits if other compensating factors were not present. It is certain, however, that its implementation will reduce other government spending and produce additional government income.

Arthur Okun has observed that a 1% decrease in unemployment increases real national product by 3%. Even assuming this to be high it is logical to infer that a reduction of unemployment from 8.% to 3.5% under full working hours conditions would contribute between 125 and 175 billion dollars annually to the GNP and thus contribute significantly to government revenues. Simultaneously it could virtually replace present expenditures of $13 billion for unemployment compensation, $4 billion for capital

investment tax credits and $4 billion for public service jobs. In addition it would help to eliminate waste and make more effective some $10-12 billion spent for manpower training programs.

In estimating costs directly for each element of the Human Investment Tax Credit the following computations are put forward for discussion purposes:

1. Employment incentives of $1,000 per person for some 4 million individuals that need to be drawn into the work force to reduce unemployment to 3.5% would cost $4 billion. Assuming approximately 1 million of the new employees would be individuals under age 20, the total cost for this element would increase from $4 billion to $4.5 billion.

2. An estimate of the Workshare Bonus cost is calculated on an addumed 5 million employees willing to reduce their work time by one day drawing an unearned 10% bonus of wages throughout the full year. At an average annual full time wage of $8,000 ($4 per hour for 2000 hours) this would amount to $4 billion. This amount is far less than the cost in unemployment compensation if the reduced labor time prevents prospective or current unemployment.

3. Expanded saving and investment incentives are going to have a cost that is more difficult to estimate. If 18 million employees (under 20% of the total and about 65% of a recent estimate of U.S. shareholders) participated, the cost could be estimated at $9 billion. If matching requirements were 1 for 1 the incentive would generate $18 billion in employee equity investments. If the matching requirement was set at 2 employee dollars for each incentive collar then equity investment would increase to $36 billion dollars. There would be a multiplier effect of some unknown magnitude in meeting capital needs of business.

4. Self-employment incentives would cost approximately $9 billion assuming some 6 million self-employed individuals would claim average credits of $1,500 each, which is 60% of the maximum.

5. Improved training incentives would cost another $3 billion assuming a maximum of 6 million individuals would be trained and their employers thus made eligible for this credit.

It is easy to see that these estimates are high and could be expected to be substantially less. It is worth noting, however, that the $29.5 billion price tag would be offset by reduced unemployment compensation and public service employment expenditures as well as lost revenues saved by other tax changes. In addition tax revenues would be increased by an unknown amount due to the additional GNP induced by these credits.

F. Summary.

A new approach is needed if we are to solve the problems of inflation, recession and unemployment. The capital investment credit offers less benefits for the costs incurred than would a human investment or employment tax credit.

With adequate support to expedite the work involved, the human investment tax credit program could be rapidly instituted. We hope such support can be found without delay.

POST SCRIPT

This project was initiated in response to a combination of events. In the summer of 1974, foreseeing the onset of the current economic recession, L.V. Watkins recommended to the administration and Congress a Human Investment Tax Credit. At approximately the same time, a similar recommendation was made by Robert Edmonds and Mark Goldes.

Due to Congressional and Administrative interest and the need for further documentation, both proposals were referred to the Technical Assistance Division of the Economic Development Administration. Since these proposals represented an expansion of economic development concepts previously funded by that office and addressed a national economic concern, a grant amendment was made to enable the implementation of this project.

The objective of the project was to refine and document the Human Investment Tax Credit concept. The end product was to be a document consisting of the following:

1. An Executive summary of Key Human Investment Tax Credit provisions.
2. A general economic justification of the need and cost of such a credit.
3. A research proposal to study new Economic Policy initiatives consistent with the Human Investment Tax Credit and the mission of the Economic Development Administration.

The Project Staff:

The project director was L.V. Watkins. Robert Edmonds and Mark Goldes served as Project Associates. The Project Supervisor, John Lesley, is Executive Director of the National Area Development Institute.

Watkins was Executive Director of the Eastern Oklahoma Development District from 1969 to 1974. As a member of various state advisory committees, he played an active role in shaping state planning programs particularly involving community affairs and the utilization of technology in management improvement at state and local levels. Watkins has degrees in law and economics. Between 1967 and 1969 he served as a research economist in the Legal Institute for Agriculture and Resource Development at the University of Mississippi. In 1964-65, he was a staff assistant to the Agricultural Committee of the U.S. House of Representatives. He is now employed as a Special Assistant with the Council of State Governments.

Robert Edmonds is Vice President and Director of Research for The AESOP Company. His special interest and qualification in the economics of ownership deconcentration extends back more than a decade. From 1972 to 1974 Edmonds acted as Controller for the Berkeley Housing Authority and Redevelopment Agency. He also acted as budget officer with the Redevelopment Agency of the City of Oakland. Edmonds is a former Assistant Professor of Economics at San Jose State University, San Jose, California. In Tokyo after World War II he served as an associate industrial economist with the U.S. government as well as a reparations analyst and Chief of Claims and Allocations.

Mark Goldes is the President of The AESOP Company. His experience in the field of Economics and Social development extends back to the 1960's, when he acted as a consultant for long range economic development planning for the Bedford-Stuyvesant Project in the office of the late Robert Kennedy in New York. He has been Chief of Housing and Economic Development for the Redevelopment Agency of the City of Oakland.

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